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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

COMMISSIONERS**DOCKETED**

JEFF HATCH-MILLER Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

DEC 09 2005

DOCKETED BY

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IN THE MATTER OF THE APPLICATION OF
VALENCIA WATER COMPANY, INC. FOR
AUTHORITY TO ISSUE DEBT.

DOCKET NO. W-01212A-05-0606

DECISION NO. 68336**ORDER**

Open Meeting
December 6, 2005
Phoenix, Arizona

BY THE COMMISSION:

On August 24, 2005, Valencia Water Company, Inc. ("Applicant") filed with the Arizona Corporation Commission ("Commission") an application requesting authorization to issue long-term debt to the Water Infrastructure Financing Authority ("WIFA") in an amount not to exceed \$2,831,000.

On October 19, 2005, Applicant filed certification that it had provided notice of the application by publishing in a newspaper of general circulation.

On November 7, 2005, the Commission's Utilities Division Staff ("Staff") filed its Staff Report, recommending approval of the application.

* * * * *

Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

1. Pursuant to authority granted by the Commission, Applicant is an Arizona corporation that provides water service in and around Buckeye, Maricopa County, Arizona.

2. On August 24, 2005, Applicant, as authorized by its Board of Directors, filed with the

1 Commission an application requesting authorization to issue long-term debt to WIFA in an amount
2 not to exceed \$2,831,000.

3 3. On October 19, 2005, Applicant filed certification that it caused notice of the
4 application to be published in the *West Valley View*, a newspaper of general circulation in Avondale,
5 Buckeye, Goodyear, Litchfield Park and Tolleson, Arizona.

6 4. Applicant's request for issuance of debt arises from rules established by the United
7 States Environmental Protection Agency ("EPA") that require the maximum contaminant level for
8 arsenic in potable water to be reduced from 50 parts per billion ("ppb") to 10 ppb, effective January
9 23, 2006.

10 5. The proposed financing will be used for the construction of a water treatment plant to
11 remove arsenic from Applicant's water system in order to meet the EPA and Arizona Department of
12 Environmental Quality ("ADEQ") January 23, 2006 deadline for compliance.

13 6. On November 7, 2005, Staff filed its Staff Report, recommending approval of the
14 application.

15 7. On November 14, 2005, Staff filed its Notice of Errata for its Staff Report in this
16 matter.

17 8. Staff stated that it examined the construction plans and estimated costs for Applicant's
18 water treatment project and found them to be reasonable and appropriate.

19 9. Staff stated that the proposed financing is for a 20-year loan which is to be amortized
20 at an estimated interest rate of 5.85 percent.

21 10. Staff performed an analysis of Applicant's financial statements for the twelve-month
22 period ended December 31, 2004; however, those financial statements did not provide an accurate
23 representation of ongoing operating results because Applicant's customers have since increased by
24 almost half, from approximately 1,900 to almost 3,000. Subsequently, Applicant provided Staff
25 updated information projecting operating results for the twelve months ending December 31, 2005
26 with actual financial results through August 2005, along with projections of operating expenses for
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1 the proposed plant. Staff reviewed the updated information and tested¹ the Applicant's projections
2 and pro forma adjustments. Staff accepted only the Applicant's projections that pertain to the
3 operation of the arsenic treatment plant for its analysis.

4 11. For the period ending December 31, 2005, Applicant's capital structure is projected to
5 consist of 1.53 percent short-term debt, 13.30 percent long-term debt, and 85.17 percent equity.

6 12. Staff's analysis showed that if Applicant were to draw the entire \$2,831,000, the
7 resulting pro forma capital structure would consist of approximately 2.17 percent short-term debt,
8 68.88 percent long-term debt and 28.95 percent equity.

9 13. The Debt Service Coverage ("DSC") ratio represents the number of times internally
10 generated cash will cover required principal and interest payments on long-term debt. A DSC ratio
11 greater than 1.0 means that operating cash flow is sufficient to cover debt obligations, A DSC less
12 than 1.0 means that debt service obligations cannot be met from operations and that another source of
13 funds is needed to avoid default.

14 14. The Times Interest Earned Ratio ("TIER") represents the number of times earnings
15 will cover interest expense on short-term and long-term debt. A TIER greater than 1.0 means that
16 operating income is greater than interest expense. A TIER of less than 1.0 is not sustainable in the
17 long term but does not necessarily mean that debt obligations cannot be met in the short term.

18 15. Based on its analysis of the projected 2005 financial statements, Staff determined that
19 the pro forma effect of Applicant's proposed \$2,831,000 loan if fully drawn would be a lowering of
20 the Applicant's TIER from 25.78 to 1.53 and a lowering of the Applicant's DSC from 13.88 to 1.79.
21 Staff concluded that the pro forma TIER and DSC ratios show that the Applicant has adequate cash
22 flow to make interest payments on the proposed debt².

23 16. Applicant seeks WIFA financing approval for arsenic treatment of four current
24 operating well sites and four additional well sites scheduled to come on-line in February 2006. The
25 current arsenic levels of these wells range from 14 ppb to 38 ppb. Applicant plans to install FlexSorb

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27 ¹ Staff compared Applicant's projected September 2005 revenue (i.e., \$110,000) to its actual revenue (i.e., \$157,000) and
concluded that the Applicant's revenue projections are not overstated.

28 ² Calculation reflects the current interest rate of 6.56 percent on the proposed loan. WIFA interest rate calculation for this
loan: (Prime Rate + 2%) x Subsidy Rate = (6.75% + 2%) x .75 = 6.56%.

1 Modular Sorption Systems as water treatment systems that use ArsenX media to remove arsenic.
2 ArsenX is a new hybrid arsenic removal media that uses nano-particle technology to combine iron
3 chemistry and plastic bead durability.

4 17. A Staff engineer reviewed the Applicant's proposal and found the estimated project
5 costs provided by the Applicant to be reasonable and appropriate. Staff further stated that no "used
6 and useful" determination was made and no conclusions should be inferred for ratemaking or rate
7 base purposes.

8 18. Staff concluded that the capital structure that would result from the incurrence of the
9 \$2,831,000 proposed debt is acceptable in the short-term. However, Staff believes that this capital
10 structure is outside the desirable range for the long-term.

11 19. Based on Staff's concerns for Applicant's long term capital structure, Staff
12 recommends approval of the Applicant's application for authorization to issue long-term debt to
13 WIFA in an amount not to exceed \$2,831,000 subject to the following condition: that if and when
14 equity falls below 40 percent of total capital, the Applicant is prohibited from distributing more than
15 25 percent of each year's earnings or distributing assets to principals via salaries, management fees,
16 or otherwise, in excess of current levels adjusted for changes in the Consumer Price Index.

17 20. While the Commission is concerned about the under capitalization of public service
18 companies, we do not believe that at this time Valencia's reduction in equity requires a restriction as
19 recommended by Staff in Finding of Fact 19. As evidenced in Findings of Facts 11 and 12,
20 Valencia's capital reverses as a consequence of financing the arsenic remediation project(s). If
21 Valencia did not have to comply with the unfunded mandate of the Federal government to reduce the
22 arsenic standard, Valencia's equity position would be very strong. Further, there is no evidence in
23 the record that Valencia has made any inappropriate distributions to principals or employees. As the
24 record is devoid of any improper disbursements and since this company appears to be doing the right
25 thing by complying with the Federal mandate, we do not believe in this instance it is necessary to
26 restrict any distribution as recommended in Finding of Fact 19. We do believe, however, that
27 Valencia should file an affidavit stating its current and prospective capital structure with the
28 Commission. While the Commission at this time does not agree with the proposed restriction,

Valencia is placed on notice that the Commission will review Valencia's capital structure and may, at a later date, impose similar conditions if the Commission is not satisfied that Valencia is maintaining a proper capital structure.

21. Because an allowance for the property tax expense of Applicant is included in the Company's rates and will be collected from its customers, the Commission seeks assurances from the Company that any taxes collected from ratepayers have been remitted to the appropriate taxing authority. It has come to the Commission's attention that a number of water companies have been unwilling or unable to fulfill their obligation to pay the taxes that were collected from ratepayers, some for as many as twenty years. It is reasonable, therefore, that as a preventative measure Applicant annually file, as part of its annual report, an affidavit with the Utilities Division attesting that the company is current in paying its property taxes in Arizona.

22. Staff's recommendations, with the exception of Finding of Fact 19, are reasonable.

CONCLUSIONS OF LAW

1. Applicant is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-285, 40-301 and 40-302.

2. The Commission has jurisdiction over Applicant and the subject matter of the application.

3. Notice of the application was given in accordance with the law.

4. The financing approved herein is for lawful purposes within Applicant's corporate powers, is compatible with the public interest, with sound financial practices, and with the proper performance by Applicant of service as a public service corporation, and will not impair Applicant's ability to perform that service.

5. The financing approved herein is for the purposes stated in the application and is reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably chargeable to operating expenses or to income.

ORDER

IT IS THEREFORE ORDERED that the application of Valencia Water Company, Inc. for authority to issue long-term debt to the Water Infrastructure Financing Authority in an amount not to

1 exceed \$2,831,000 is hereby approved subject to the condition that Valencia Water Company, Inc.
2 shall file certification within 365 days of this Decision and annually thereafter with the Commission's
3 Docket Control, as a compliance item in this docket, an affidavit of its current and prospective capital
4 structures.

5 IT IS FURTHER ORDERED that Valencia Water Company is hereby authorized to engage in
6 any transactions and to execute any documents necessary to effectuate the authorization granted
7 herein.

8 IT IS FURTHER ORDERED that such authority is expressly contingent upon Valencia Water
9 Company's use of the proceeds for the purposes set forth in its application.

10 IT IS FURTHER ORDERED that approval of the financing set forth herein does not
11 constitute or imply approval or disapproval by the Commission of any particular expenditure of the
12 proceeds derived thereby for purposes of establishing just and reasonable rates.

13 IT IS FURTHER ORDERED that Valencia Water Company shall file with the Commission
14 copies of all executed financing documents setting forth the terms of the financing, within 30 days of
15 obtaining such financing.

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IT IS FURTHER ORDERED that Valencia Water Company, Inc. shall annually file as part of its annual report, an affidavit with the Utilities Division attesting that the Company is current in paying its property taxes in Arizona.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

 CHAIRMAN	 COMMISSIONER	
 COMMISSIONER	 COMMISSIONER	 COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 9th day of Dec., 2005.


BRIAN C. McNEIL
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

AB:mj

1 SERVICE LIST FOR: VALENCIA WATER COMPANY, INC.

2 DOCKET NO.: W-01212A-05-0606

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